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The Honorable George H. Mahon, Chairman
Committee on Appropriations
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

Noting your particular interest in Indonesia when I had the privilege of appearing before you last Wednesday, I asked my associates, upon my return to the Agency, to prepare a special study for you which would highlight the details presented to the President the week before. I hope that you will find this useful.

In the event that there is an aspect of the Indonesian situation on which you would like greater detail, please be so kind as to let me know and I will be glad to provide whatever information we are able to procure.

Respectfully yours,

/s/ Richard Helms

Richard Helms
Director

Attachment

RHelms/ecd - 12/8/66
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THE SITUATION IN INDONESIA

The Indonesian army, under its able leader General Suharto, is the dominant power factor in Indonesia today. A year ago it was on the political defensive, its influence circumscribed, its leadership and ranks infiltrated, virtually forbidden to oppose the steady drift of the nation toward Communism.

The abortive Communist-oriented coup last October, which infuriated army leaders and galvanized them into action, turned into an historic watershed in the evolution of Indonesia's post-independence. The reaction swept the generals into power and, for the time being at least, shattered the Communists as an effective political force.

The generals, however, were left with a country reeling from years of misrule under Sukarno's "Guided Democracy." At the same time that they have been maneuvering against President Sukarno's determined efforts to regain control, they have had to set to work methodically to stabilize the national economy and the body politic.

Today, the political scene is developing quite satisfactorily from the army's viewpoint, but the economic situation is critical and could undo the progress made in the political arena if the drift continues. The chaos of the past can be blamed on Sukarno; the continuing failure to remedy the situation could be brought home to the new leaders.

The Political Situation

The Indonesian domestic political situation continues along lines favorable to the army and to General Suharto. In contrast, President Sukarno's position and prestige are declining progressively.

The most dramatic recent manifestation of the erosion of Sukarno's power was the ratification on 11 August of an agreement formally ending Indonesia's three-year undeclared war against Malaysia. Only two weeks earlier, Sukarno had publicly called for

a continuation of his "confrontation" policy against Malaysia. The occasion for this outburst, however, was the installation of a new cabinet which reflected the new order in Indonesia and further registered Sukarno's declining power. The speech merely spurred General Suharto's efforts to finalize the agreement with Malaysia, which had been delayed since June largely by Sukarno's footdragging.

The agreement itself leaves much to be desired. The published text calls for an immediate end of hostilities, the immediate establishment of diplomatic relations, and an early opportunity for the 25X1 people in the Borneo territories of Sarawak and Sabah to restate their willingness to remain in the Malaysian federation. [redacted]s, however, makes the actual establishment of diplomatic relations and the exchange of missions conditional on 25X1 the holding of some form of election or plebiscite 25X1 in the Borneo territories. [redacted], [redacted] the Indonesians, although willing and even anxious to end open hostilities, have not abandoned their ultimate objective of detaching the Borneo territories, if only through political subversion. Even so, the accord with Malaysia marks yet another milestone in Djakarta's slow progress back to a saner and more manageable domestic and international posture. The end of confrontation will certainly reduce the budgetary burden, and could make Western powers more receptive to Indonesian requests for new aid and leniency on existing debts.

Elsewhere in the international sphere, Indonesia is firmly embarked on a course of friendly relations with the West. Foreign Minister Malik has stated that Indonesia hopes to be back in the United Nations as an active member by late September. Indonesia has sharply disengaged from Sukarno's pro-Peking policy and has curtailed its diplomatic efforts in the Afro-Asian world considerably.

The new cabinet formed late last month represented another victory for Suharto at Sukarno's expense. Especially hard for Sukarno to swallow was retention in the new cabinet of the triumvirate--Suharto, Foreign Minister Adam Malik, and the Sultan of Jogjakarta--which had been effectively running the

country ever since Sukarno reluctantly gave Suharto special executive powers last March.

The major concession to Sukarno was a post of little real power for a badly shopworn Moslem politician whose position is shaky even within his own party, the Nahdatul Ulama (NU). The balance of the 29-member cabinet is made up of army officers, representatives of political parties, and a sprinkling of technicians. The cabinet leaves something to be desired, particularly in ministries dealing with the economy, but it is probably the best Indonesia has had in a number of years. In addition, Suharto's office has a "kitchen cabinet," composed of army officers assisted by university specialists in the economic sphere, which is expected to have a substantial role in formulating policy for the new government.

Suharto received his mandate to form a new cabinet from the Indonesian Congress, which met in late June and early July. In a series of wide-ranging decrees the congress also: (1) reaffirmed Suharto's special executive powers granted by Sukarno last March; (2) revoked Sukarno's life presidency but provided that he remain in office until an elected congress chooses a president--some two years hence; (3) reaffirmed Suharto's earlier ban on the Indonesian Communist Party and in addition proscribed the propagation of Marxism-Leninism "in any form"; and (4) decreed that elections be held within two years and that an election law be written within six months.

In addition to preventing a revival of the badly hurt Communist Party of Indonesia (PKI), Suharto has two major domestic political tasks: the control of Indonesia's opportunistic political factions, and the continued downgrading of Sukarno and Sukarnoism. The latter is still a delicate task in view of Sukarno's significance in emotional terms to the average Indonesian, particularly in densely populated Java. Minor incidents provoked by pro-Sukarno elements are still occurring in East and Central Java.

Nevertheless, Suharto, supported by the able, dynamic and intelligent Malik on the one hand, and profiting from the Sultan of Jogjakarta's symbolic

and traditional ties with the masses on the other, has made remarkable strides in embarking Indonesia on its new path. In effect, political progress has cleared the decks for more intensive concentration on Indonesia's major problem: halting its economic decline and beginning the long up-hill struggle toward development and modernity.

Economic Problems

The Indonesian economy is in chaos, and only the fact that most Indonesians live outside of the modern economy has prevented a disaster. The country's most urgent problem is how to get the bankrupt economy back on a sound basis. The nation's economic plight may become the country's principal political issue.

So far, Sukarno and those who advised him in the pre-October period are still being blamed for the galloping inflation, declining production, and tremendous foreign debt. Unless effective remedial action can be developed, however, an antiregime atmosphere could easily develop which could be exploited by the political parties, coup-minded army officers, extreme nationalists, and Communist elements. The result could be political chaos, or a complete army take-over; a return to authoritarian government could occur.

Suharto and those around him are aware of these possibilities. They base their hopes for economic stabilization and progress largely on foreign aid.

The Indonesian Government faces short- and long-term foreign obligations far beyond its ability to pay--more than $2-1/2 billion. The USSR is Indonesia's largest creditor, mainly for military assistance. There are no foreign exchange reserves, and $160 million in foreign obligations are in default. Debt servicing requirements for 1966 are estimated at $550 million, a sum exceeding Indonesia's current annual export income.

Indonesia wants to reschedule payments on its international debt and wants help in working out a domestic program of economic stabilization.

Free world creditor nations have ostensibly agreed that debt rescheduling should be approached on a multilateral basis. Representatives of nine creditor nations who met in Tokyo on 19 July recognized the urgency of Indonesia's economic problem, but did not go beyond a decision to convene another formal multilateral conference in mid-September. The nine nations were the United States, Japan, United Kingdom, Netherlands, West Germany, Italy, France, Australia, and New Zealand, with Canada as an observer.

Indonesian industries are operating at less than 30 percent of capacity, mainly because of a lack of spare parts and raw materials. Even agricultural production--normally 60 percent of the national income--has declined. Only petroleum, which remains under foreign management, has prospered.

A basic problem of the Indonesian economy is the lack of managers, skilled labor, and entrepreneurial talent. The Dutch provided little training for the Indonesians, and the Indonesians have aggravated the shortage by ousting foreigners with managerial and technical skills. Repressive actions against overseas Chinese since the October 1 coup have further reduced the ranks of traders and entrepreneurs.

The Indonesian transport system has deteriorated rapidly during recent years. It could barely meet the rock-bottom service requirements of the military and the civilian economy. Now the situation has become critical, and even essential movements cannot be assured. During the first half of 1966, up to 80 percent of the ships in inter-island service were idle for lack of spare parts and lubricating oils. The government was able to maintain only 25 percent of the surfaced roads. More than 50 percent of the trucks and buses were incapacitated for lack of spare parts and maintenance. Imports of new vehicles have been held up because of the lack of foreign exchange. Railroad service also has been hampered by the lack of spare parts and adequate maintenance. Even the civil airline, Garuda, has run into an acute shortage of spare parts, and will need emergency assistance to maintain domestic schedules.

The major items in the Indonesian budget have been grandiose and unproductive public works projects of the Sukarno era, and expenditures associated with the military. Progress on Sukarno's pet projects has been stopped, and expenditures for sophisticated military hardware may be curtailed. With the military leaders in control of the government, however, there is little prospect that expenditures for the maintenance of armed forces personnel can be reduced. It may be possible to use military personnel in civil action programs to help economic recovery.

Government expenditures are often two to three times revenues. There is no adequate system of revenue collection. The central bank finances the difference by simply printing more banknotes. The recent currency reform has only reduced the number of digits. These persistent budget deficits have been the main cause of an inflation which has raised prices 500 percent over the past six months.

No quick, easy solution is available for the Indonesian economy. Multilateral action by Indonesia's creditors to ease its debt servicing burden is an indispensable step. A multilateral framework may also be feasible for the granting of some new aid, but most of Indonesia's creditors are concerned mainly with safeguarding their own interests. As a result, there may be an urgent need for aid, particularly from the United States.

Before Indonesia can begin to think of the long pull toward stabilization and development, a substantial salvage operation will be necessary. Indonesia has an immediate urgent need for cotton and other materials to rekindle lagging industry, and for spare parts for the variegated inventory of transport and industrial equipment. There is no immediate danger of a food shortage, but rice may be short this winter. Indonesia may need to import 500,000 tons this year to meet food requirements.

Some progress has been made. Trade with Singapore is to be resumed. Trade regulations have been altered to encourage exports. The government has reapplied for membership in the International Monetary Fund, but faces a major obstacle in the $47.4 million required for readmission. The Fund has

suggested that some of the creditors might provide this as part of their aid program, but leading creditors have not been responsive. In any event, the Fund will provide experts to help draft a financial program to restore international credit and domestic financial responsibility on readmission.

Recovery will require years of effort even with the best domestic talent and liberal foreign economic assistance. Indonesia has the climate, land and people to build a comfortable if not a flourishing economy, but organization and motivation of the population will be difficult.

Foreign aid can give the country hope and tools. It cannot provide will and dedication. The most encouraging sign is that the present Indonesian leaders seem inclined to face reality. They recognize the sources of the present economic chaos, if not its full magnitude. They also realize the political cost, both to them and to the nation, if they are unable to achieve some economic progress.

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ANNEX

INDONESIA'S COTTON REQUIREMENTS

Indonesian economic statistics are slow and inadequate, but various figures are available concerning Indonesia's textile spinning capacity and its requirements for raw cotton. Estimates of the total number of spindles available in Indonesia's 14 spinning mills range between 320,000 and 384,000. Many of these spindles are inoperable because of defective maintenance and the lack of spare parts so that these figures overstate Indonesia's actual capacity. Production is also hampered by inadequate supplies of raw cotton and electric power. It is estimated that mills now are operating at only 10 to 15 percent of capacity. According to figures provided by Indonesian government officials, 42,240 metric tons of raw cotton would be needed to keep all spindles (384,000) operating on three shifts. The textile ministry, however, anticipates that only 71 percent of the spindles will be operable in the coming year. On that basis, total requirements for raw cotton will be 30,000 metric tons--of which 27,000 (or 150,000 bales) must be imported. Of this import requirement, 75,000 bales are to be provided under a United States PL-480 agreement. No other contracts to import raw cotton are known to have been signed.

ANNEX

STATUS OF US BUSINESS INTERESTS IN INDONESIA

In late 1964 and early 1965, the Indonesians took over the control and management of all United States investments except for the oil companies. At that time the Indonesians announced that the take-overs did not constitute expropriation, as no attempt was being made to take over ownership rights. As a consequence, no payment to United States interests would be required. It was generally assumed, however, that ownership of the seized assets would eventually be officially transferred to the Indonesian Government, with some compensation paid.

In April and May 1966, the Indonesian Government signed agreements with U.S. Rubber and Goodyear, providing for the payment of $4.1 million to U.S. Rubber and $4.5 million to Goodyear over a period of seven years. Payment will probably be made in the products of their former estates, although under the terms of the agreement it could also be made in U.S. dollars. The role of the rubber companies in Indonesia now is limited to the marketing of rubber produced on the government-owned estates.

No provision has yet been made to compensate other U.S. firms, but arrangements are being made between the Indonesian Government and the U.S. Embassy in Djakarta for the orderly processing of claims.

Both Caltex and Stanvac, the two major U.S. oil companies operating in Indonesia, retain their assets, but Stanvac is currently negotiating for the sale of its South Sumatran assets. Caltex operations in Indonesia have continued to be profitable. Stanvac's refinery operations, however, have been unprofitable for some time, and the company apparently hopes that a sales agreement can be concluded. There now appears to be some question whether the Indonesians actually want to go through with the purchase. Agreement has already been reached on a purchase price of $27.75 million, but a major sticking point remains. The company wants the government to guarantee the refinery sales agreement, so that the guarantee will remain valid even if Permina, the government-owned oil company conducting the negotiations, is abolished.

ANNEX

THE DUTCH-INDONESIAN CLAIMS DISPUTE

The Dutch-Indonesian claims dispute has been by far the most important issue hampering an increased Dutch presence in Indonesia.

Dutch claims against Indonesia fall into two major categories. The first consists of the debt initially transferred to Indonesia at the Round Table Conference of 1949 which granted independence to the republic.

The second part of the Dutch claim results from the 1958 Indonesian decision to nationalize Dutch enterprises which had been taken over in 1957 and 1958 in the campaign to annex Dutch New Guinea (now called West Irian). Although Indonesia had admitted the validity of at least some of the Dutch claims, there has been no agreement as to the amount.

Since the resumption of diplomatic relations between Indonesia and the Dutch in 1963, three meetings have been held concerning the claims dispute. During the first meeting in November 1964 at the Hague, little progress was made; most of the discussion concerned the implementation of a Dutch 100 million guilder credit issued in August 1964. The second series of talks in August and September 1965 also failed to reach specific agreements on the claims issue. In May 1966, an Indonesian economic delegation led by Umarjadi, the Deputy Foreign Minister, arrived in the Hague to discuss the possibility of additional economic assistance. The Dutch apparently hoped that some settlement could finally be reached on the claims issue, but again no final agreement was reached although the Dutch were reported to have offered substantial concessions. These concessions included the scaling down of claims from 4 billion guilders ($1,105 million) to approximately 1.2 billion guilders ($332 million); a grace period for as much as four or five years; and 25 to 30 years for repayment.

Table 1

Medium-Term and Long-Term Debts of Indonesia
as of December 1965

	Million US $		Million US $
International Monetary Fund	102.4 a/		
Free World		Communist Countries	
Japan	203.8	USSR	992.8
United States	166.3	Yugoslavia	97.8
West Germany	142.6	Poland	94.6
France	107.2	East Germany	61.4
Italy	98.6	Czechoslovakia	57.9
United Kingdom	36.9	Hungary	17.4
Netherlands b/	25.4	Rumania	15.0
India	8.5	Communist China	13.9
Austria	6.9	Bulgaria	1.0
Sweden	3.1		
United Arab Republic	3.0		
Switzerland	20.2		
		Total	2,276.7

a/ Est drawings. Indonesia's original gold contribution offsets part of this sum, making actual payment obligations $63.5 million.
b/ Figures do not include Dutch claims for seized property and debts transferred at the 1949 Round Table Conference.

Table 2

Short-Term Debts of Indonesia
as of November 1965

	Million US $		Million US $
Free World		Free World (Continued)	
Japan	119.0	Sweden	0.2
United States	47.2	United Arab Republic	0.2
Netherlands	26.4	Australia	0.1
Pakistan	21.6	Mexico	0.1
West Germany	14.0	Canada	Negl.
Italy	20.1	Communist Countries	
Switzerland	3.7	Czechoslovakia	15.2
France	3.0	USSR	17.5
Hong Kong	0.9	Yugoslavia	10.2
India	2.0	Poland	6.2
Zanzibar	1.5	East Germany	3.6
Philippines	1.4	Hungary	3.6
Belgium	1.3	Bulgaria	1.7
Norway	1.2	Rumania	0.9
Austria	0.7	Other	Negl.
Finland	0.3		
Denmark	0.3		
Iraq	0.4		
		Total	324.8